

MEMORANDUM

DATE: Tuesday, August 20, 2013

TO: Richard Ellis, State Treasurer
David Damschen, Deputy State Treasurer

FROM: Brain F. Baker
Zions Bank Public Finance

RE: Providence Hall Charter School

The purpose of this report is to document Providence Hall Charter School's ("PHCS" or the "School") adherence to the eligibility standards created for participation in the Utah Charter School Credit Enhancement Program (the "Program"). The analysis contained herein is based on PHCS's full application to the State Charter School Finance Authority (the "Authority") as well as additional information and documents submitted in response to follow up requests by the Authority.

The School has provided all information requested subsequent to the submission of the initial application. All questions have been answered to my satisfaction. This report will examine each category of the Program's "Standards for Participation," including Basic Eligibility, Enrollment/Student Demand, Academic Performance, Management, Financial Performance, and Bond Documents. In each of these categories, the School met the basic eligibility requirements for participation in the Program, as detailed below. This report should be examined in direct conjunction with the Letter of Certification for Providence Hall from the State Charter School Board ("SCSB Letter"), which provides detailed analysis and historical information on Enrollment/Student Demand and Academic Performance.

Providence Hall—Introduction

PHCS is a K-9 charter school located in Herriman City, currently operating at its full student authorization of 1,550 students for the 2013-2014 school year in grades K-11. Over the next two years the School will be adding high school grades and increasing enrollment to 2,150 in the 2014-2015 school year. With over 3,700 students on the waiting list, they should not have a problem meeting next year's full enrollment goal, with the addition of a high school building

(as part of this financing) and the 12th grade. The School's charter was issued in 2008, and the original charter authorized up to 700 students in grades K-6.

PHCS's focus and mission appears to have remained constant from their original charter application. The school will be the first and only school in Utah to offer a K-12 International Baccalaureate curriculum (highlighted by S&P as a credit strength). The mission statement reads:

Our mission is to encourage students to think critically, communicate effectively, and act responsibly in an ever changing Global Community.

The School is looking to issue approximately \$24.6 million in revenue bonds to fund the construction of a high school building just across the street from their existing junior high facilities, and to refinance outstanding bonds issued in 2009 for the acquisition of the Providence Hall Elementary School. The new high school building will consist of approximately 81,642 square feet of space, 35 regular classrooms, library/media center, full kitchen with large cafeteria, and gymnasium with bleacher seating for 750.

Basic Eligibility

1. Providence's 2013 bonds will be issued through the Authority.
2. The SCSB Letter indicates that Providence Hall is in good standing with the State Charter School Board.
3. The School has obtained an investment grade rating of "BBB-" from Standard & Poor's ("S&P"). Key credit concerns from the private rating report are listed below, followed by Zions' response to these concerns :
 - a. Aggressive growth plans—This is cited as a risk, but S&P says several times they don't believe, given their track record and waiting lists, that PHCS will have a problem meeting those growth targets.
 - b. Construction risk for the expansion—this is a risk with any new building project. The School is experienced in construction of new facilities. The school anticipates selection of a contractor and establishment of a Guaranteed Maximum Price (GMP) by the second week of September.
 - c. Elevated pro-forma debt burden of 22% based on fiscal 2012 expenses—this is due to the growth of the school. The debt burden declines as the school adds students over the next two years, settling in around 14.3% past 2017.
 - d. The subordinate position of the 2013 bonds relative to the revenues and property of the junior high school—this is mitigated by the school history of successful operations, but the risk must be acknowledged that if the School were to completely go into default, USDA would hold a superior lien through their financing of the junior high school building in 2012 (in the amount of about \$10 million). We anticipate that these bonds, like the 2009 USDA bonds being

refinanced by the refunding portion of the 2013 bonds, will be refinanced through the CSFA credit enhancement program when economically viable.

- e. Charter risk (risk that charter could be revoked)—with Utah’s evergreen authorizations this is not a significant concern;

S&P also cites the following as positive credit factors that offset the above-listed weaknesses:

- a. Strong demand as demonstrated by consistent enrollment at charter capacity even through growth;
 - b. Pro-forma maximum annual debt service coverage of 1.2x and 1.4x based on fiscal 2012 and 2013 results;
 - c. 64 days’ cash on hand;
 - d. Unique curriculum as a certified International Baccalaureate school which differentiates it from other area schools;
 - e. Good management and governance.
- 4. PHCS has been in operation for 5 full years, which is cited as a credit strength by S&P. Operational history, as demonstrated by past audited financials, indicate that the School has maintained a stable and consistent operating performance.
 - 5. The School has a defined and specific mission based on its position as an authorized International Baccalaureate Program School with a mission and curriculum that support that program.
 - 6. WPA has not previously borrowed funds through a tax exempt or other tax-advantaged financing. Two previous financings were done as notes payable to the USDA. The refinancing part of the 2013 bonds will pay off the first USDA loan done for the elementary school. The second loan for the junior high facilities will remain outstanding. For that loan, USDA holds a senior lien on the assets they financed (the junior high school).

The Authority will have a first lien on the refinanced elementary school assets and on the new high school assets through the 2013 bonds. Zions is comfortable that the senior lien held by USDA on the junior high facilities do not in any way put the Authority in a worse credit position than on a typical Authority financing for a new school.

In an unforeseen default scenario, the Authority is protected by its first lien on the assets financed by the 2013 bonds. Only in the case where liquidation of 2013 bond assets is insufficient to repay the bonds and there are extra funds remaining after the repayment of the USDA note with the proceeds from the junior high liquidation does this USDA senior lien matter. In such a scenario, the Authority can only benefit from the equity held by the Providence in the junior high assets (approximately \$400,000) plus the small reserve fund of \$88,000.

Enrollment/Student Demand

7. The School had 1,465 students enrolled last year. 2013-2013 enrollment will be at the new increased capacity of 1,550 students, and will grow to 2,150 students the following year with the completion of the high school building and addition of the 12th grade.
8. Since opening in 2008 with 700 students, PHCS has operated at full enrollment except for one year when they made a strategic decision not to do so. The School has shown increasing enrollment with no period of decline. Table 1 from the SCSB Letter includes detailed enrollment history back to 2008.
9. Providence Hall exceeds the re-enrollment standard established by the SCSB in each of the past four years (the only years for which this data is available). The most recent total re-enrollment rate of 89.6%, coupled with the school's strong historical track record, indicate admitted students are staying through the final available grade. Table 2 from the SCSB Letter details historical enrollment and re-enrollment.
10. PHCS exceeds the ADM rate requirement. Over the last three years, PHCS's Average Daily Membership rate has been 99%, 100%, and 99%.
11. The School has provided wait list statistics by grade, and should provide the detailed waiting list that includes descriptive and personal information on potential students to the Deputy State Treasurer. The current waiting list is very strong, and includes 3,720 potential students who were not selected through the lottery process for admission for the 2013-2014 academic year, including 208 who are siblings of currently enrolled students.

Academic Performance

12. The SCSB Letter indicates that the School meets required academic standards. Table 3 from the SCSB Letter provides a breakdown of Providence Hall's performance relative to the median and high scores for charter schools statewide. The School's 2012 academic score of 87.8 is significantly above the state charter median of 74.7.

Management

13. The School has adopted reasonable management policies and practices that guide financial, debt, and risk management. A draft policy for compliance with bond covenants was included in the application and is slated to be adopted by the Board following completion of the financing, in case any covenants or measurements change.
14. PHCS has a diverse and stable Board with staggered terms. In addition, they benefit greatly by the expertise of their Head of School, which is an attorney and was also a

founding member of the school. The current Board Chair is a CPA/Auditor, and the Vice Chair has a degree in and significant experience in the education field.

15. The school has contracted with Charter Solutions for financial management support. They also have an in-house business manager who provides financial oversight. The Board of Trustees oversees financial operations in their governance roll.
16. Providence Hall's 2012 budgeted revenues differed from actuals by slightly more than 5% due to local replacement funding coming in higher than anticipated. Expenditures, as shown in their financial statements, differ from budget by 129% because the new lease they entered for their junior high facility was booked as a capital lease. Without this lease, the school's expenditures were within 3% of budget. In both 2010 and 2011, both revenues and expenditures were closely in-line with budgets.

Financial Performance

Under the Financial Performance section we have included tables provided by WPA as part of the application for participation in the Program. The tables include helpful historical information on the financial ratios and metrics we analyze as part of the Program application. Where we have deviations from the WPA calculations we have made note and provided an explanation for the difference.

17. Projections used by the School in proforma forecasting appear reasonable based on anticipated growth. Assuming Providence Hall successfully completes its expansion to 2,150 students, they should be well positioned to continue with healthy financial standing. PHCS revenues are forecasted to grow at a slightly faster rate than expenses, but this is offset by the large amount of coverage and flexibility the School appears to have even under a higher expense growth assumption. Past financial results coupled with current projections indicate coverage and liquidity levels can be maintained. The School appears to be in a healthy financial position.

18. Debt Coverage Ratio

Requirement	Measure	Sufficient?
At least 105%	134%	Yes

Debt coverage ratio is calculated by dividing total revenues available for debt service by the maximum annual debt service payment anticipated for the new bonds. Revenues available for debt service is calculated by taking fiscal year 2013 net income from operations of \$1,985,692 and adding back depreciation expense of \$459,976. This leaves net revenues available for debt service of \$2,445,668. When this number is divided by anticipated maximum annual debt service of \$1,823,132, the coverage is 134%.

Providence Hall has made all payments when due on previous bonds and leases. Because the School grew from 700 to 1,416 student between the 2011 and 2012 fiscal years, it is not helpful to look at debt service coverage in years prior to 2012. In fiscal 2012, the PHCS demonstrated that it can provide

adequate coverage (121%) for maximum annual debt service intended to support 2,150 students with just 1,416 students. Coverage will increase with enrollment, and is anticipated to be over two times by 2015.

	2013	2012	2011
Net Income Available for Debt Service	<u>\$2,445,668</u>	<u>\$2,201,163</u>	<u>\$537,356</u>
Maximum Annual Debt Service	1,823,132	1,823,132	1,823,132
Debt Coverage Ratio	134.1%	120.7%	29.4%

19. Debt Burden Ratio

Requirement	Measure	Sufficient?
Less than 25%	20.9%	Yes

The debt burden ratio requirement is based on the level of the School's fund balance, which we calculate at 27.7% (cash of \$1,863,124 divided by total operating expenses net of depreciation of \$6,733,364). Debt burden ratio is calculated as maximum annual debt service (\$1,823,132) divided by unrestricted operating revenues (\$8,715,756), taken from 2013 unaudited financial statements.

	2013	2012	2011
Maximum Annual Debt Service	<u>\$1,823,132</u>	<u>\$1,823,132</u>	<u>\$1,823,132</u>
Unrestricted Operating Revenues	8,715,756	7,982,292	3,807,892
Debt Burden Ratio	20.9%	22.8%	47.9%

As with the debt coverage ratio, comparisons of the new maximum annual debt service with years prior to 2012 are unhelpful. If the School meets its enrollment growth targets for this year and next year, debt burden will fall to approximately 12%.

20. Operating Margin

Requirement	Measure	Sufficient?
At least 7%	22.7%	Yes

Providence Hall's operating margin requirement of 7% or greater is based on the calculation for days cash on hand (calculated as cash divided by operating expenses multiplied by 365) of 91 days. Operating margin of 22.7% is calculated by dividing net income available for debt service of \$2,445,668 (see calculation under Debt Coverage Ratio) by total revenues of \$8,715,756.

	2013	2012	2011
Net Income Available for Debt Service	<u>\$2,445,668</u>	<u>\$2,201,163</u>	<u>\$537,356</u>
Revenues	8,715,756	7,982,292	3,807,892
Operating Margin	22.7%	27.6%	14.1%

21. Current Ratio

Requirement	Measure	Sufficient?
At least 150%	395%	Yes

The current ratio is defined as current unrestricted assets (\$2,525,049 for 2012 unaudited numbers) divided by current liabilities (\$640,003). PHCS has exceeded a 150% current ratio each of the last four years, including unaudited 2013 results.

Providence Hall	2010	2011	2012	2013
Current Assets	1,299,459	1,305,730	1,679,119	2,525,049
Current Liabilities	508,762	512,851	1,001,048	640,003
Current Ratio	255%	255%	168%	395%

Bond Documents

20-23. WPA's legal bond documents have been reviewed by Chapman and Cutler in their capacity as bond counsel to the Authority, and all requirements have been incorporated. In addition, Ballard Spahr, as bond counsel to Providence Hall, has confirmed that each of the required legal provisions is present in the bond documents.